The Impact of the Canada/U.S. Trade Agreement: A Legal Analysis

---

Attorney General for Ontario

May 1988

KF
6668
C3
I56
1988
c.2

The impact of the Canada/U.S. trade agreement: a legal analysis / Attorney General for Ontario

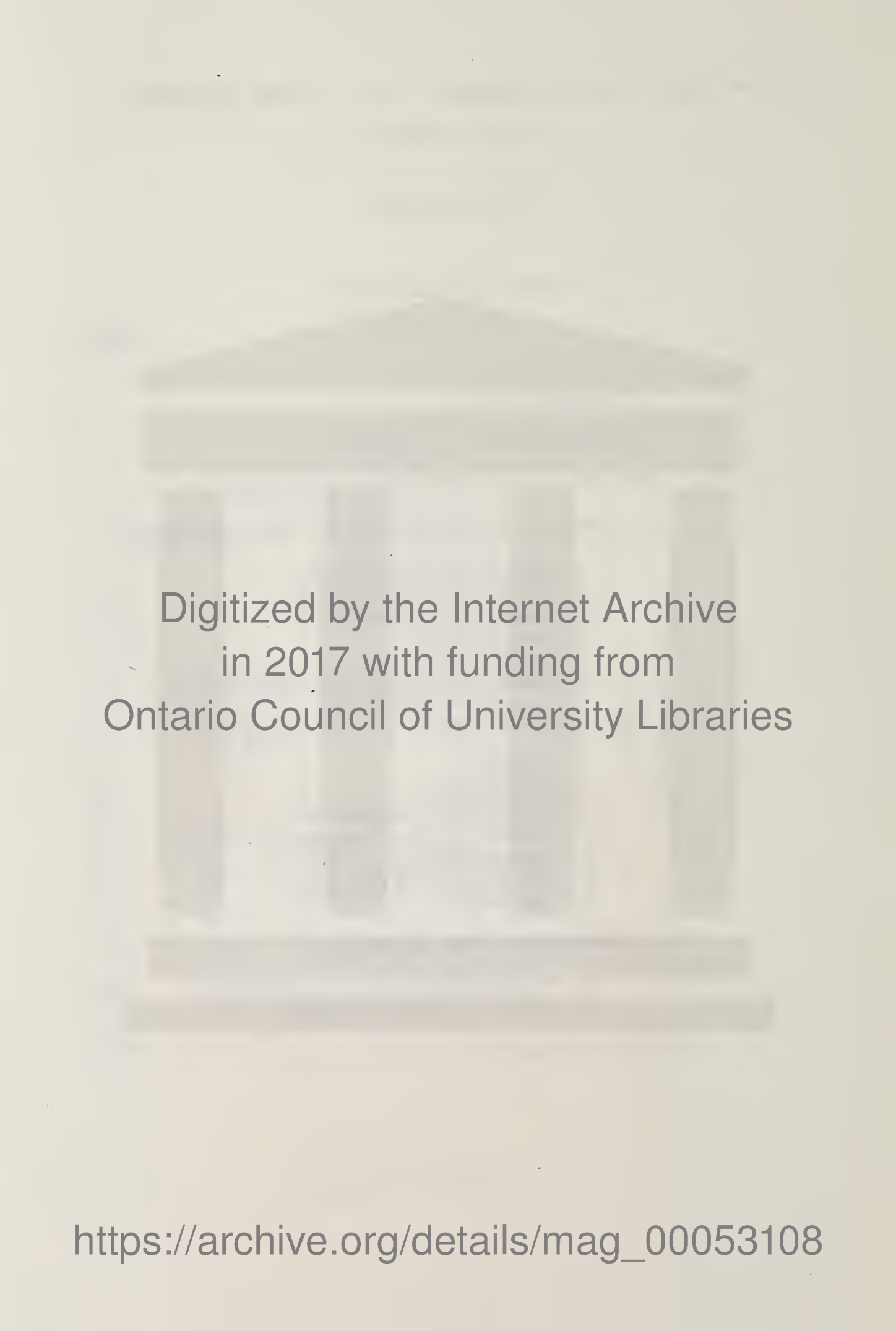
The Impact of the Canada - U.S. Trade Agreement

A Legal Analysis

MAY 25, 1988

Table of Contents

	page
I. Introduction	1
II. Federalism in Canada	4
III. The Constitutional Dimension	8
IV. General Obligations of the Agreement	13
1. National Treatment	14
2. No Discrimination	20
3. Technical Standards	24
4. Monopolies	27
5. Subsidies	30
6. Nullification and Impairment	36
V. Sectoral Effects of the Agreement	44
1. Energy	44
2. Resources	53
3. Alcoholic Beverages	61
4. Services and Temporary Entry	65
5. Investment	73
6. Financial Services	81
7. Culture	83
VI. Enforcing the Agreement	87
1. The Extent of the Agreement	88
2. American Retaliation	93
VII. Conclusion	96



THE IMPACT OF THE CANADA - U.S. TRADE AGREEMENT

A LEGAL ANALYSIS

I. Introduction

The trade agreement signed by Canada and the United States on January 2, 1988, will significantly affect the ability of the provinces of Canada to shape their economic and social policies. It reduces the capacity of the provinces to govern and gives both the Canadian federal government and the federal government of the United States important new roles in influencing provincial policies. It will give

the United States a seat at the Canadian constitutional bargaining table.

This shift of power away from the provinces gives the Free Trade Agreement its constitutional dimension. The present study examines the effect of the Agreement on the provinces, focusing not only on the programs that may or will have to change but also on the capacity of the provinces to continue or to create programs that meet the future needs of their residents. This is the context within which Ontario must evaluate present and future measures of the federal government designed to implement the Agreement.

The study sets forth briefly the advantages that Canada derives from the current balance of the federal and provincial roles in Confederation. It goes on to present a brief overview of the Agreement and why it represents a constitutional challenge to the provinces. It then analyses the Agreement in more detail, first examining its principal terms and the obligations undertaken by the government of Canada - to provide national treatment for goods, services and investment, to harmonize technical standards, to control state and private monopolies, and others - then turning to provincial powers in specific sectors dealt

with in the Agreement, such as energy, natural resources, services, investment, and culture.

This is followed by a discussion of the methods by which the federal government, or the government of the United States, may in practice limit provincial activity to make it consistent with the Agreement.

It is not the purpose of this study to explain in detail why the Ontario Government believes that the Agreement is not good for Canada. That explanation is available elsewhere. Likewise, the federal government's power to govern is impaired by the Agreement, but this aspect of it is not discussed in detail.

Any discussion of the Agreement is only partly a matter of economics. It must also touch on the limitations on the powers of government. The publication of this study may help clarify the stakes in this aspect of the debate, one that is important to the future of federalism in Canada.

II. Federalism in Canada

> The rules of federalism are especially significant in Canada because they protect the cultural, linguistic and regional diversity of the nation.
>
> Peter Hogg, Constitutional Law of Canada (second edition, page 1)

The Constitution Act, 1867, which united the provinces of British North America to form a federal state, allocated all powers between the central and provincial governments. The provinces were deemed better able to reflect regional concerns and thus were given control over matters "of a merely local or private nature", including the regulation of business and the economy on a provincial scale. The federal government was assigned the powers needed to manage the national economy, such as the public debt, banking, legal tender and the regulation of trade and commerce.

As the role of the governments expanded, particularly in the latter half of the twentieth century, both the federal and provincial governments have found themselves called on to act in areas of responsibility that were not contemplated by the Constitution. Many of these areas, for example, social welfare, post-secondary education and urban development, have been taken up by the provinces. Provincial governments have also assumed more responsibility for economic development within their regions.

The growth of state intervention has likewise had an impact on the federal government. Ottawa has been asked to support and implement, at the national level, initiatives that have succeeded in individual provinces, such as medicare.

Both orders of government in Canada are therefore legitimate representatives of the wishes of the population. Both try to create an economic and social climate in which Canadians can prosper.

The expanding role of the state and the growing interdependence between levels of government has sometimes led to disputes. Both levels have

intervened in matters not clearly allocated to either, or in areas where only one had been active.

Some disputes have led to litigation; most have been settled by various sorts of political compromise. Canadian federalism has been characterized by its ability to resolve interjurisdictional disputes through accepted procedures based on compromise and harmonization. The present allocation of powers owes much to such federal-provincial accommodation, as well as to formal amendments and judicial interpretation.

Sometimes conflicts between levels of government have been tolerated for several years, rather than either level pushing for a resolution, or "standing on its rights", in a way that would cause legal or political difficulties for the other. National programs have been created, usually not by undoing provincial jurisdiction but by harmonizing provincial and national responsibilities to create a workable system across the country.

These traditions of adaptation have become part of the rules of Canadian federalism. One eminent scholar, Professor J.A. Corry, has even referred to

their observance as an element of "constitutional morality".

Flexible and balanced federalism has served Canadians well. The provinces can represent efficiency, responsiveness and creativity. It is difficult for a central government adequately to take into account the interests of all sections of the country in every matter.

Effective and secure powers at the provincial level have encouraged a degree of variety and even experimentation in economic and social regulation. This has allowed the "testing" on a smaller scale of policy initiatives that might be too risky to originate nationally. For example, provincial medical and pension schemes, while tailored to the needs of regional communities, have spurred the adoption of similar programs across the country.

The success of Canadian federalism is predicated on perpetual compromise between the national claim of unity and provincial claims of diversity, since Canadians have divided loyalties to each claim.

Neither level of government can permanently prevail over the other. Canada is well served by both. This discussion does not intend to elaborate on the politics of constitutional accommodation, but merely to indicate that changing the legal basis for federal-provincial cooperation threatens the benefits that Canada derives from its flexible and balanced federal system. The Agreement does change that legal basis in a number of ways.

III. The Constitutional Dimension of the Agreement

The federal government has asserted that the Free Trade Agreement is "97% federal". If this means that 97% of the changes required to be made immediately on the coming into force of the Agreement will be at the federal level, then it may have some merit, though of course percentages are meaningless in such matters. Over the longer term, however, the assertion is false. Several chapters of the Agreement deal expressly with matters extensively regulated by the provinces in ways that may have to change over the

several years until the Agreement takes full effect. The Agreement will in fact have a widespread impact on the ability of the provinces to make economic and social policy.

The Agreement does not purport to change the formal legal division of powers prescribed by the Constitution Act, 1867, and developed by amendment, judicial interpretation and federal-provincial compromise since Confederation. Such a change could not be made unilaterally. However, the Agreement will permanently alter the capacity to make economic and social policy in Canada, sometimes shifting it to the federal government, sometimes abandoning it for all governments. This dramatic change in the ability of governments to respond to the legitimate expectations of their populations amounts to a constitutional change.

Moreover, a constitutional change is implied by the manner in which the Agreement menaces the practices of balance and consensus that are the essence of federal-provincial accommodation and that have been an enduring feature of Canada's constitutional principles.

In addition, the federal government will be obliged to assert interpretations of the Constitution that go beyond what the courts have allowed to federal authority in the past. Success in such assertions would change the formal division of powers as well.

The impact on the provinces is not incidental but results from a deliberate undertaking of the federal government under the Agreement. Article 103 binds the parties to:

> ensure that all necessary measures are taken in order to give effect to its provisions, including their observance, except as otherwise provided in this Agreement, by state, provincial and local governments.

The provinces of Canada, like the states of the United States, are not parties to the Agreement and under our law are not directly bound by it. However, the federal government has obliged itself to the United States to "ensure that all necessary measures are taken" to fulfill all aspects of the Agreement. If the provinces do not voluntarily implement or abide by the Agreement in areas of their constitutional

jurisdiction, then the federal government must ensure that they do. If the provinces do not take the appropriate measures, then the "necessary measures" will necessarily be federal. The federal implementing legislation is the first but certainly not the only step in the process.

The intent of this phrase can be seen clearly from Article 601.2. That provision exempts provincial technical standards from the reach of the Agreement. "Accordingly, the Parties need not ensure the observance of these provisions by state or provincial governments." For the rest of the Agreement, ensuring their observance is expressly the duty of the federal governments.

The obligation undertaken in Article 103 is much stronger than is Canada's custom in international agreements, notably in the General Agreement on Tariffs and Trade (GATT).

The federal government may act directly on provincial measures, asserting its primacy over them, by passing federal legislation that makes inconsistent provincial laws inoperative or that precludes new provincial initiatives that would be inconsistent with

it. The federal government may assume regulatory authority over works and undertakings by declaring them to be "for the general advantage of Canada". It may be able to disallow provincial laws.

The federal government may also act indirectly, but effectively, by unilaterally changing laws with which the provinces have harmonized their own laws, either through interlocking legislation or through following federal leads. It may use its spending power to impose conditions on federal grants to ensure provincial compliance with the Agreement.

Finally, the federal government has by signing the Agreement exposed the provinces to the very forceful threat of American retaliation against Canada through sanctions resulting from use of the dispute settlement procedures of Chapter 18. The federal government is not obliged to defend provincial actions attacked by the U.S., nor have the provinces any independent right to be heard in such disputes. If the Canadian government cannot "ensure" compliance in accordance with Article 103, the U.S. government may be able to do so.

Giving these possibilities of legal action to the United States has itself a constitutional dimension for Canada. The practice of federal-provincial cooperation will be much more difficult if the United States can insist that the federal government must avail itself of all its legal rights in the event of any dispute with the provinces over the implementation or interpretation of the Agreement. The compromises on contentious issues that have often served Canadian federalism well in the past will suffer from the threat of American retaliation.

The effect of all of these techniques of primacy or persuasion, the use of which is required or made possible by the Agreement, is to diminish, in a way that will be very hard to reverse, the provincial capacity to govern.

IV. General Obligations of the Agreement

This part examines obligations under the Agreement that apply to more than one sector of the economy. The government of Canada is required to ensure

that all necessary measures are taken to give effect to these obligations, which, in the absence of provincial action, will require federal compulsion.

1. National Treatment

The fundamental obligation of both parties, as set out in Article 105 of the Agreement, is to accord to persons of the other party "national treatment with respect to investment and to trade in goods and services." The idea of national treatment is found in Article III of the GATT, where it applies only to trade in goods. The GATT concept is referred to in Article 501 of the Agreement. This means, in the words of the federal summary, that once goods have been imported into either country, they will not be the object of discrimination. As the GATT does not apply to trade in services or to most rules for investment, the Agreement further defines national treatment in Articles 1402.1 (services) and 1602.1 (investment).

The obligation to provide national treatment expressly extends to provincial measures. Article 502 spells this out for goods, Article 1402.2

for services, and Article 1602.4 for investment. For example, here is Article 1402.2:

> The treatment accorded by a Party under paragraph 1 shall mean, with respect to a province or state, treatment no less favourable than the most favourable treatment accorded by such province or state in like circumstances to persons of the Party of which it forms a part.

"Persons of the Party of which [the province] forms a part" could mean Canadians outside the province itself, or it could mean any Canadians, including those within the province. The better view is that it extends to all Canadians, even those within the province. This means that if a province gives its own residents any preference over residents of other provinces in matters covered by the Agreement, then it must give Americans the same preference. In other words, the Agreement requires the province to treat Americans better than Canadians from other provinces.

For example, a new measure such as the one already in force in Prince Edward Island restricting land sales to non-residents could apply to other Canadians but not to Americans, at least where business uses were concerned.

The requirements of the GATT have not led to this kind of result, for two reasons. First, the GATT applies chiefly to trade in goods. Most provincial measures that affect interprovincial trade do not relate to goods, except in procurement, where neither the GATT nor the Agreement affects provincial practices. Second, the federal government has under the GATT the less intrusive obligation to take "such reasonable measures as may be available" to achieve provincial compliance with the GATT rules. The Agreement requires it to "ensure that all necessary measures" are taken to give effect to the rules.

The obligation is, as stated, to give to Americans the most favourable treatment given to local residents "in like circumstances". It is probable, though not completely certain, that this would permit a province to favour one region over another, or one class of person, say by way of an affirmative action plan, without having to give the same favoured treatment to all Americans, whoever and wherever in the

province they were.

The national treatment standard under the Agreement is tempered by an exception, though a limited one. Some provincial (and federal) measures respecting services may refuse national treatment to Americans for "prudential, fiduciary, health and safety or consumer protection reasons" (Art. 1402.3(a)), if certain other conditions are met. The burden of proving that these reasons apply under the appropriate conditions falls on the province denying national treatment. The investment chapter has similar provisions in Article 1602.8. The goods chapter includes by reference the rules under Article III of the GATT, as interpreted by the Contracting Parties to the GATT since its formation (Art. 501.2).

Without discussing all the possible meanings of national treatment and the exceptions to it, which would involve an exploration of subjects unrelated to the issues at hand, it should be noted that many of the terms are vague and have no clear meanings either in the Agreement or in international law. The GATT rules themselves are not always clear, and they have not been applied to services or, generally speaking, to investment. As a

result, definitive interpretation of crucial aspects of the Agreement may have to await the resolution of disputes under Chapter 18.

The provinces now have many programs and policies that do not accord national treatment to American businesses. National treatment may be denied for a number of reasons, not all of them easily fitting within the exceptions to the general obligation expressed in the Agreement. A province might want to deny national treatment to maintain control of economic activity vital to the province in provincial or Canadian hands, or to supervise foreign ownership of resources. It might wish to ensure that people offering services to the population have adequate knowledge of local conditions. It might wish to promote local economic activity by ensuring preferential markets for its products, whether goods or services. It might want to help local cultural activities flourish in an overwhelmingly foreign cultural environment.

As a result of the obligation that the federal government has undertaken in the Agreement, Ontario will be restricted in many of its policies. Some of the examples mentioned may be allowed to

continue as "existing measures" within the meaning of the Agreement, although there is no grandfathering in the parts of the Agreement on trade in goods. Further policies of the same nature in all areas will be restricted or at least subject to U.S. retaliation..

Here are some examples found in Ontario statutes. Under the Ontario Energy Corporation Act, Ontario restricts the foreign ownership of the Ontario Energy Corporation to 10 percent. It requires non-residents of Canada to pay a higher rate of land transfer tax when they purchase recreational or agricultural land in Ontario. A special register is kept of foreign-controlled corporations and individuals not resident in Canada who own agricultural land. Only Canadian citizens or permanent residents are entitled to licences to sell liquor in Ontario. Foreign ownership of collection agencies is restricted. Foreign ownership of corporations that distribute paperback books and periodicals is restricted.

Non-statutory forms of regulation may be even more important than statutes in denying national treatment.

From this discussion it can be seen that the national treatment rule established in the Agreement substantially affects the ability of the province to continue to regulate its economy as it has been doing. Many legitimate policy aims of the province are threatened by the Agreement.

2. No Discrimination

Although the most general obligation of the parties is to accord national treatment to persons of the other party, in some areas the Agreement imposes a slightly different requirement, either instead of or even in addition to national treatment. This is the vague prohibition against undue discrimination.

Perhaps the broadest statements of this duty are found in Chapters 14 and 16 on services and investment. Article 1402.8 reads as follows:

> Notwithstanding that such measures may be consistent with paragraphs 1, 2 and 3 of

this Article [according national treatment] and Article 1403 [licensing and certification rules], neither Party shall introduce any measure requiring the establishment or commercial presence by a person of the other Party in its territory as a condition for the provision of a covered service, that constitutes a means of arbitrary or unjustifiable discrimination between persons of the Parties or a disguised restriction on bilateral trade in covered services. [emphasis added]

Article 1403.2 says:

Each Party shall ensure that such measures [on licensing and certification] shall not have the purpose or effect of discriminatorily impairing or restraining the access of nationals of the other Party to such licensing or certification.

Article 1407 provides:

> Subject to Article 2011, this Chapter shall not apply to any new taxation measure, provided that such taxation measure does not constitute a means of arbitrary or unjustifiable discrimination between persons of the Parties or a disguised restriction on trade in covered services between the Parties. [emphasis added]

Article 1609 dealing with investment makes the same provision as Article 1407, in paragraph 1 with respect to new taxation measures, and in paragraph 2 with respect to any subsidy, new or existing. (The meaning of the reference to Article 2011 on nullification and impairment is discussed later in this study at page 36.)

In Chapter 8 on wine and spirits, the general obligation of national treatment applies to listing and distribution practices. However, the obligation on pricing is expressed in terms of "any discriminatory pricing measure", which is to be eliminated except as spelled out in that Article.

Article 905 on energy gives each party a right to consultation if the other party's energy

regulatory actions "would directly result in discrimination against its energy goods or its persons inconsistent with the principles of this Agreement."

The Agreement does not say when discrimination is arbitrary or unjustifiable, particularly when standards for denying national treatment have already been set out for the same rules, as in the regulation of services or investment.

Article 1403.2, however, bars measures with "the purpose or effect" of discrimination, so a non-discriminatory purpose alone will not preserve the measure.

Just as the obligation to accord national treatment will prevent Ontario and other provinces from carrying on their economic and social policies as they now do, so too will these separate prohibitions of discrimination.

3. Technical Standards

The province applies standards to economic activity in many ways for many purposes. Much provincial economic regulation is in the form of standards.

The Agreement binds the federal governments of Canada and the United States to refrain from using legislative or regulatory standards for the provision of goods as barriers to the import of those goods from the other country. The only permissible standards that may function as trade barriers are those to protect health and safety, environmental, "essential security" and consumer interests, and even these are to be harmonized "to the greatest extent possible."

While the Agreement exempts some provincial standards from its coverage (Article 601.2), it does extend to agricultural and food standards (Article 708). In this area, the Agreement requires the parties to "work toward" harmonization of standards in a number of domains. This may affect current efforts to devise a coordinated set of federal and provincial food standards, as it gives the United States an important

voice in the deliberations. If the federal government is more willing to satisfy American demands for harmonization than to cooperate with the provinces, provincial goals will be hard to implement. Regardless of their constitutional rights, the provinces will be put under pressure to follow suit in order to avoid a balkanization of regulatory regimes across Canada.

In any case where provincial standards are set in conjunction with federal standards, whether by formal interlocking legislation or by informal harmonization, the provincial rules will be threatened by federal changes made to please the U.S. Such coordinated standards are common in Canada. Most provincial building codes closely resemble the federal code regulated by the Canada Mortgage and Housing Corporation (CMHC). The Agreement in Article 2008 contemplates a change in the standard for plywood used in construction. The federal and provincial governments have cooperated in setting standards for information on hazardous materials in the workplace. If the U.S. wished to weaken these standards, or pursue different standards, provincial rules would be pressed to follow.

Where the provinces have set standards in areas that can also be regulated federally, the federal government could render the provincial rules inoperative by passing inconsistent legislation within its own jurisdiction. Standards relating to health and safety, either in food or in workplace regulation, may provide examples. The threat to provincial standards is therefore not just added inconvenience of inconsistent rules, but sometimes the invalidity of the provincial initiatives.

In none of these cases does the Agreement oblige the federal government to change its standards or to follow an American lead. Nor will the provinces necessarily disagree with new standards reached in a compromise with the United States. Nevertheless, the attempts to harmonize Canadian and U.S. standards will almost certainly lead to changes in some Canadian standards. This will affect related provincial standards, whether or not the provinces have been consulted in the process and whether or not they agree in the result.

Despite its apparent exclusion of provincial standards from Chapter 6, therefore, the Agreement may well affect provincial measures.

4. Monopolies

In Canada it is common for governments to establish or to authorize entities to be the sole provider of a good or a service. This may occur in what economists call "natural monopolies" such as utilities, or in areas where a significant public interest in the means of providing the product is held to override the freedom of any person to provide it. The Agreement will impose strict limits on the right of provincial governments to create such monopolies in the future.

Article 2010 of the Agreement allows the Parties to "maintain or designate" a monopoly. "Designate" is defined to include establishing, designating, authorizing, or expanding the scope of a monopoly. The Agreement does not prohibit provinces from creating monopolies. The federal government is obliged by Article 103 to ensure that the monopolies provisions of the Agreement are observed by the provinces. Otherwise, the provinces would be free to do what they wanted in this field.

In creating a new monopoly (or expanding the scope of an existing one), a Party must notify and consult with the other Party, and attempt to minimize the effects of the monopoly on the interests of the other Party. The conduct of such a monopoly is subject to limits, both in the "monopolized market" and in "any other market" (not just in the market of the other Party).

Further, the general permission to create monopolies is subject to Article 2011, which affords remedies to a Party respecting any measure that nullifies or impairs benefits reasonably expected from the Agreement. Since the permission to create monopolies is made expressly subject to Article 2011, new forms of monopoly activity are subject to extra scrutiny by this reference. (The meaning of Article 2011 is further explored in the section on nullification and impairment at page 36)

Ontario has in the past, in common with other provinces, chosen to provide certain essential services to the public through regulated monopolies, whether privately or publicly owned. Two examples from other provinces are telephone services, a provincial monopoly in the prairies, and public automobile

insurance, a provincial monopoly in Manitoba, Saskatchewan and British Columbia. The class of such services is not closed.

However, the Agreement provides in Article 1605 that neither Party may "directly or indirectly" nationalize or expropriate an investment in its territory or "take any measure or series of measures tantamount to an expropriation of such an investment" without fair compensation. This general principle is commonly recognized. It is arguable that it would be a measure "tantamount to expropriation" to create a public monopoly, or even a private one, that prevented businesses that previously sold the monopolized services from continuing to sell them. This would be a new legal result in Canada.

In the case of Manitoba Fisheries v. the Queen, [1979] 1 S.C.R. 101, the Supreme Court of Canada held that legislation that created a monopoly in a federal Crown corporation and drove a private company out of business "took" the latter's goodwill. The Crown had to pay for the goodwill. The Court stated that legislation that clearly ruled out such compensation would have been valid. Similarly, only by statute does a person have any right to compensation

for damage short of expropriation caused by governmental regulation. (Statutes may offer compensation for "injurious affection".)

The Agreement appears to change this rule and give a contractual right of compensation for the creation of a monopoly for any public purpose. The obligation to compensate would apply only to American-owned businesses.

5. Subsidies

The power to provide financial advantages to economic activity in its territory is an important aspect of any government. Motives for granting subsidies vary greatly, from wishing to encourage kinds of business or business in particular regions to helping overcome natural or economic handicaps. The Agreement threatens the power to subsidize in three ways.

First, the whole practice of subsidies has been turned over to a series of negotiations between

Canada and the U.S. that will continue for five to seven years. The results of those negotiations are critical to the provincial power to maintain and develop almost all facets of its economic policy.

Second, although the Agreement does not purport to deal generally with subsidies, its specific terms have an impact on them in two ways. Article 1609 limits subsidies related to American investment and the conduct and operation of U.S.-owned businesses in Canada. In addition, these subsidies and possibly others are subject to challenge under the "nullification and impairment" provisions of Article 2011.

Article 1602 requires the Parties to provide national treatment to investors from the other country in the "conduct and operation of business enterprises located in its territory." Article 1609.2 says that the Chapter does not apply to subsidies, except on certain conditions. If those conditions are met, however, the general rules of Chapter 16 will apply to subsidies. These conditions are in essence

that Canada does not differentiate between Canadian and U.S. investors in delivering its subsidies. However, it is only subsidies to investors and businesses here that will have to meet these tests. There is no requirement at any time to offer subsidies to persons outside the territory.

The conditions are that the subsidy not constitute a means of arbitrary or unjustifiable discrimination between investors of the Parties or a disguised restriction on the benefits accorded to investors of the Parties under Chapter 16. The reasons for denying national treatment set out in Article 1602.8 (prudential, fiduciary, health and safety or consumer protecton reasons) are probably not enough to show that a discriminatory measure is not arbitrary or unjustifiable. This conclusion follows from the terms of Article 1402.8, which contemplates that even a measure that satisfies the criteria of Article 1402.3 (the same as those in Article 1602.8) may at the same time constitute arbitrary or unjustifiable discrimination. As a result, it is hard to know how to justify any discrimination, to preserve new subsidies from the obligations of Chapter 16.

Article 1609.2 applies to "any subsidy", while the similar provisions of Article 1609.1 on taxes apply to "any new taxation measure." While the omission of "new" from "any subsidy" might seem to expose all subsidies to the anti-discrimination standard, the effect of unjustifiable discrimination would be that the rest of Chapter 16 would apply to the subsidy. Article 1607 grandfathers existing measures. As a result, there appears to be no difference in practice between the application of the two paragraphs of Article 1609.

The ability of the province to subsidize Canadian-owned or Ontario-owned business will be impaired by the requirement that the subsidies meet this vague standard. Some new labour adjustment subsidies directed to Canadians or Ontarians might be successfully attacked under Article 1609. Regional development programs similarly restricted could face the same challenge. Without clarification of what will be considered arbitrary or unjustifiable, this conclusion cannot be avoided.

The other direct impairment of the power to subsidize arises from Article 2011, discussed in more detail at page 36. Not only is this Article expressly

mentioned in Article 1609, but in any event it applies to the entire Agreement, except for cultural industries and financial services. Article 2011 allows a party to launch a complaint under the dispute resolution procedures if the action of the other party has nullified or impaired a benefit that the complaining party could reasonably have expected to receive under the Agreement. It is irrelevant whether the action complained of violated the Agreement.

The question is whether anyone could argue that equal access to subsidies, or the absence of subsidies to Canadian competitors, could have been reasonably expected as a benefit of the Agreement. The Agreement expressly allows subsidies only for oil and gas exploration, in Article 906. However, it excludes any rights in respect of subsidies in Article 1402.9. It also excludes subsidies for investment in Article 1609.2, unless they are discriminatory as discussed. It does not mention subsidies one way or the other with respect to trade in goods, but the GATT rules on goods adopted by the Agreement give only limited rights with respect to them.

It will be hard for an American to argue that the Agreement gives rise to any reasonable

expectation of an absence of subsidies. However, a Canadian or provincial subsidy that was available equally to Canadian and American investors, and thus in accord with Chapter 16, might still be said to nullify or impair benefits reasonably expected to flow to U.S. businesses from the removal of tariffs or other trade barriers.

In any event, it would be dangerous to assume that provincial subsidies will be immune from attack under Article 2011.

The Agreement treats subsidies for service industries differently from subsidies for other businesses. The services chapter itself does not impose obligations or confer rights with respect to subsidies (Article 1402.9). Subsidies for establishing service businesses in Canada and for operating covered service businesses (listed in Annex 1408) once established, must conform to Article 1609. In subsidizing the operations of covered service businesses, a province may not "unjustifiably" discriminate between Canadian-owned and American-owned businesses if they are located in Canada. However, it can discriminate in favour of Canadians providing services, covered or not, where Americans have only the

"commercial presence" guaranteed under Chapter 14, and have not established themselves under Chapter 16. Such discrimination would be subject in turn to Article 2011.

The third impairment lies in the fact that provincial subsidies in Canada remain subject to American trade remedy laws despite the Agreement. The dispute settlement mechanism does little or nothing to protect the beneficiaries of such subsidies from U.S. lawsuits. Nor does the Agreement go very far to prevent American law from becoming more rigorous in its attack on our subsidies. These omissions are not however the subject of the present study.

6. Nullification and Impairment

The Agreement gives each Party a new right, not mentioned in the Preliminary Transcript, to consult about and complain of any federal, provincial or local measure that may nullify or impair any benefit otherwise accruing to the complaining Party under the

Agreement. The provision significantly increases the effect of the Agreement on provincial actions.

(i) the application of the Article

Article 2011 provides that if a Party considers that the application of any measure, whether or not the measure conflicts with the provisions of the Agreement, causes "nullification or impairment of any benefit reasonably expected to accrue to that Party, directly or indirectly under the provisions of this Agreement," the Party may invoke the consultation provisions and the dispute settlement provisions of Chapter 18 of the Agreement.

Article 2011.2 exempts the provisions of Chapter 19 (disputes about countervailing and antidumping duties) and Article 2005 (cultural industries) from the nullification and impairment rule. The "code" governing financial services (Chapter 17) does not include a reference to Article 2011.

On the other hand, certain other rules are expressly made subject to Article 2011. Article 1407 subjects the provision on taxation of services to the general article. Article 1609 makes the apparent

exemption for certain kinds of taxes and subsidies relating to investment the subject of complaint if they nullify or impair benefits under the Agreement. Article 2010 provides that the rules that otherwise may allow a Party to establish a monopoly are subject to Article 2011, and may therefore permit that monopoly to be challenged if it nullifies or impairs any benefit under the Agreement.

(ii) impact of the Article

Article 2011 applies to any "measure", which may be federal, provincial or local. Article 201.1 defines measure to include "any law, regulation, procedure, requirement or practice." It applies to such measures "whether or not such measure conflicts with the provisions of this Agreement." As a result, any activity whatsoever of any level of government in Canada may now be held up to comparison with the Agreement, not simply on the basis of whether the Agreement deals particularly with that activity, but on the basis of whether "any benefit reasonably expected to accrue" to the other party is "nullified or impaired" by that activity.

It is arguable that this provision is not as broad as it may at first appear. It applies only to benefits that can be "reasonably expected" to flow from the Agreement. The Agreement provides for national treatment, as described in the detailed rules of the text and subject to many exceptions for "existing measures". As a result, existing rules and existing subsidies should play no part in nullifying and impairing benefits under the Agreement. The Parties cannnot reasonably expect to eliminate these, since the Agreement permits them to continue.

The limited jurisprudence of the GATT supports this result. Measures consistent with those in force at the time the Agreement was signed, and not expressly changed by the Agreement, do not affect the benefits given by the Agreement.

(iii) relation of Article 2011 to Article 103

Similar provisions on nullification and impairment are contained in the GATT, and in other international conventions. The Article can be looked at as an "anti-loophole" clause. However, it will have a greater impact on the provinces than does the similar provision of the GATT because of the greater ease of

retaliation under the Agreement, and possibly because the obligation of the federal government to impose the Agreement on the provinces is greater than that to impose the GATT rules. This is discussed in the section "The Extent of the Agreement" at page 88 below.

The relationship between Article 103 on "all necessary measures" and Article 2011 is not completely clear. It may be that the obligations under Article 103 apply only to the imposition of measures designed to give effect to the specific obligations of the Agreement. To the extent that a complaint about nullification and impairment touches a measure that does not conflict with the provisions of the Agreement, the federal government may have no obligation to change its own ways or the ways of the province or municipality responsible for the measure in issue. Perhaps the only right of the complaining Party is that provided by Article 2011, which is to say, procedures under Chapter 18.

In that case, however, the federal government will be under pressure to act if the institutional dispute settlement procedures eventually hold such measures to be nullifications or impairments and recommend their amendment. At this point the

federal government must comply or expose Canada to sanctions.

Another reason makes Article 2011 a more serious concern to Canada and its provinces than the similar provision of the GATT. The scope of the Agreement is much broader. Far more Canadian measures are exposed to examination under this Article than under the GATT, and far more are within provincial and local competence than under the GATT, which deals primarily with tariffs and other federal matters.

(iv) effect of specific references to Article 2011

All actions of all levels of government are subject to the rules in Article 2011. Government activities not mentioned in the Agreement are also subject to complaint under that Article. In addition, apparent concessions in the Agreement are limited by being expressly subjected to the Article. As mentioned earlier, these are Article 1407 on taxation of services, Article 1609 on taxation and subsidies related to investment, and Article 2010 affecting monopolies.

It is not clear why some sections are made expressly subject to Article 2011 in this way, since the Article applies in any event to the entire Agreement, unless a specific exemption is provided. At least two explanations may be offered. First, the express reference to Article 2011 may create an obligation not to nullify or impair the benefits of the affected provision. Any measure that did have this effect would then contravene the Agreement. (Article 2011 otherwise does not have this result.) Therefore, the federal government would be obliged under Article 103 to ensure that all necessary measures were taken to obviate the offending measure. This could make the apparent concessions of Article 1609 on taxes and subsidies, for example, very small concessions indeed.

A second and perhaps better explanation for expressly referring to Article 2011 is that the provisions which do refer to it are themselves exceptions to the general rules of the Agreement. They reduce the "benefits" that might otherwise be expected to flow from the Agreement. Thus a measure contemplated by them could not logically impair any benefit expected from the Agreement as a whole. The specific reference to Article 2011 shows that such an argument would be invalid, and that measures allowed by

Article 1609, for example, still may be found to nullify and impair benefits from the Agreement, and may be attacked under Article 2011.

(v) exemption of cultural industries

The nullification and impairment provision does not apply to the exemption of cultural industries under Article 2005. This is probably because the provision of Article 2005.2 allows retaliation against any measure to protect a cultural industry. This is a greater right than that given under Article 2011, since it does not require the complaining Party to pass through Chapter 18 proceedings in order to retaliate.

(vi) effect on the provinces

Article 2011 allows only a Party to consult or complain about a measure in issue which may be a provincial measure. Neither provincial nor state governments nor businesses nor individuals may complain. Likewise, none of that group has any right to be heard concerning the effect of measures that are subject to consultation or dispute settlement, because consultation and dispute settlement take place under Chapter 18.

V. Sectoral Effects of the Agreement

1. Energy

The provisions of the Agreement will affect the provinces both as producers and as consumers of energy. In apparent contradiction of the recent addition of section 92A to the Constitution, the power of the provinces to control the development, conservation and management of natural resources is limited by the Agreement.

(i) the structure of the Agreement

The energy section of the Agreement is complex. It begins by affirming the parties' obligations under the GATT, but extends those obligations to electricity as well as other "energy goods". The GATT prohibits restrictions on the export of energy goods (and goods generally) except for certain specific reasons. The effect of bringing the GATT rules into the Agreement, besides adding

electricity to their coverage, is that these rules will be more easily enforceable than under the GATT, through the dispute resolution provisions of Chapter 18.

The ability of the parties to apply quantitative restrictions to energy exports is further restricted by Article 904 of the Agreement. Restrictions allowed by the GATT may be adopted only if three other conditions are met. First, the restriction must not reduce the proportion of the total export shipments of a particular good "made available to" the other party (Article 904(a)). Second, the restricting party may not impose a higher price for the export of an energy good than the domestic price, "by means of any measure such as licences, fees, taxation and minimum price requirements" (Article 904(b)). Finally, the restrictions must not disrupt normal channels of supply or normal proportions of specific energy goods supplied to the other party (Article 904(c)).

(ii) power to sell in priority to the domestic market

Many provinces require that provincial needs for energy be satisfied before sales are allowed

outside the province. Ontario Hydro has such a policy, as do other provincial power corporations. This policy constitutes a quantitative restriction on exports, unless the amount of energy available is unlimited and all foreign markets can be served after the domestic users are satisfied. The fact that most if not all utilities in Canada and the United States follow such policies may make challenges unlikely on this point.

Even if the policy is compatible with the GATT, Article 904 of the Trade Agreement would require that the United States be given continued access to its proportionate share of the energy, according to its purchases for the previous three years. This may affect provinces with long term export contracts for hydro. If domestic demand grows by the end of the contracts, the ability of those provinces to cut back on exports to serve the local needs at the end of the contract period will be limited by Article 904. As a result, all growth in local demand must be served by increasing production, unless local users can outbid the Americans for the energy previously sold abroad in the expired contract.

The greater the share of the U.S. energy market that is provided by Canadian energy, the harder

it will be to redirect the exported energy to domestic use and the harder to outbid American users dependent on the supply.

The United States would probably argue that it makes no difference that the sales are those of a Crown corporation rather than of a government. For the purposes of the Agreement, actions of Ontario Hydro, for example, could be argued to be actions of the province.

Likewise it makes little difference that the province may be the owner of the resource. An owner may not be required to sell in the first place, but once the owner has sold to the United States, then a Party - whether regulator or provincial owner - may not impose a quantitative restriction that reduces the proportionate supply made available to the U.S. So long as no restrictions were in place, the decision of owners not to sell would not be remediable under the Agreement.

A province acting only as regulator of any energy goods is subject to federal legislation to make it comply with the Agreement. The powers of the provinces under section 92A of the Constitution yield to paramount federal laws on the same subject.

As a result, Canada and the provinces are limited in their ability to reserve domestic production of energy goods for local consumption, both by the GATT and by the Agreement. It may be noted that the application of these rules to contracts for interruptible delivery of energy, such as electricity, is far from clear. It is at least arguable that the assured access of Article 904 would pre-empt provincial attempts at interrupting delivery, at least in contracts made after the Agreement comes into force.

It is true that Canada and the U.S. are already parties to an international arrangement that requires the sharing of petroleum resources with other countries in times of shortage. The Agreement is made subordinate to the international treaty by Article 908. The Agreement however goes beyond the multilateral convention in its terms and of course extends to other forms of energy goods as well as to oil.

(iii) the power to favour domestic users with lower prices

Many provinces ensure that users of energy within the province are charged a lower price than those outside the province. This is particularly true of electrical power, but Alberta also enforces such a policy for oil and gas sales through a system of removal permits. The Agreement will make this policy difficult to maintain, though the complexity of the provisions makes certainty on this point impossible.

Higher export prices are possible if they are not "imposed". The ability to maintain a price differential will also depend on the type of goods. Oil is more easy than electricity for brokers to arbitrage, transferring supply to meet demand at the best price, with the result of fairly consistent prices throughout world markets. Maintaining a price differential in the oil market is accordingly much more likely to require quantitative restrictions than it is in the market for electricity.

In the presence of quantitative restrictions, what can the province do? It can sell to

the U.S. at a higher price than it charges at home, if it does not impose that higher price. If, in other words, U.S. buyers are prepared to pay more than the provincial domestic price for energy, nothing prevents the seller from charging that much. This is, as noted earlier, subject to market arbitrage forces if they are allowed to operate. Likewise, nothing prevents the seller from charging different amounts to different U.S. purchasers, all higher than the Canadian domestic price, according to what the market will bear.

It appears from this discussion that a province may impose a domestic price for energy. If this price is lower than what energy will attract on the open export market, the Agreement does not affect the provincial policy nor prevent the province from charging the higher price for exports. However, the province may not compel provincial sellers to charge a particular high price for exports. If energy exporters chose to lower their export price to compete for markets, the Agreement would not permit the province to impose a higher price.

Nonetheless, to the extent that such pricing policies depend on quantitative restrictions or even constitute quantitative restrictions, they may be

vulnerable to attack under the Agreement on the ground that the quantitative restrictions themselves are improper. The ability of the province to favour its domestic users of energy is thus impaired by the importation into the Agreement of the GATT, the source of the ban on quantitative restrictions.

If the province wishes to subsidize domestic producers by imposing a low domestic rate for energy, the Agreement may not prevent this. However, the products of industries so subsidized might be subject to existing United States trade laws, which might in turn impose countervailing duties on those products if injury to U.S. competitors could be shown. Nothing in the Agreement prevents such a result.

(iv) power to secure supply from other provinces

At present, the National Energy Board requires that electrical energy resources not be exported if users in other provinces are willing and able to buy the resources instead. However, the Trade Agreement would prevent such a policy from reducing the supply of energy goods from what has traditionally been

made available to the Americans (Article 904(a)). To that extent, it impairs the ability of a province to secure a source of energy from another province before the energy is exported.

The NEB policy allows the guaranteed access only at the price at which the energy would otherwise be exported. It is a form of right of first refusal. If the province wishing to buy the energy from the province wishing to export it can outbid the potential American customers, then Article 904 would allow such a purchase. The Agreement prohibits a government from setting a policy of preferring other Canadian purchasers over U.S. purchasers at the same price for the proportion of Canadian energy supplies that the U.S. has traditionally bought. If Canada increases its share of the U.S. market, then Canadian supply will become even more expensive. At the same time it will probably be harder to maintain a lower domestic price because of the price competition.

This result follows logically from the fact that a province cannot even ensure its own supply in the face of Article 904, as discussed in an earlier section of this discussion. Section 92A(2) of the Constitution may prevent a province from favouring its

own consumption over demand in other provinces, and from charging other provinces more. "In each province ... laws in relation to the export from the province to another part of Canada [of energy] ... may not authorize or provide for discrimination in prices or in supplies exported to another part of Canada." If this is held to mean only that a province cannot discriminate between other provinces, rather than between itself and any other, then a producing province will just have to share its production with the U.S. The Americans will therefore be in a better position than the consuming provinces of Canada.

2. Resources

The Agreement contains no express provisions on trade in resources, except for the energy chapter discussed above. Resources are covered as goods and therefore fall within the rules of Chapter 5 according national treatment by GATT standards and Chapter 4 on border measures.

Chapter 5 imports GATT Article III, which sets out rules for national treatment of foreign products once within the territory of the member country. It prohibits internal regulation or taxation that discriminate against goods from another member of the GATT. The Agreement will prevent Canada or a province from requiring that imported resources be treated differently from Canadian resources, or that any person should buy Canadian or provincial resources in preference to American resources. (This rule does not however apply to government purchases.) Article III of the GATT does not prevent subsidies to local goods.

Another, potentially more serious, impact will be felt from Articles 407, 408 and 409. These articles reproduce for all goods the provisions of Articles 902, 903 and 904 on energy goods. They accordingly bring the GATT rights into the trade in goods between Canada and the U.S.; they also bar export controls and minimum price requirements except as they are allowed as quantitative restrictions under the GATT. Though Canada and the United States are already members of the GATT and bound by it, having the GATT rights in the Agreement will make them easier to enforce, especially against Canada (because of the uneven ability to retaliate for their breach.)

Article 409 ensures the U.S. proportionate access to Canadian resources in the same way as does Article 904 in the Energy chapter. Likewise, Canada and its provinces may set no minimum export price on the export of resources by any measure such as licences, fees, taxation and minimum price requirements.

While Canada and the provinces have not usually wanted to place restrictions on the export of resources, seeking rather to increase exports, the Agreement will nevertheless affect certain kinds of resource policies. The most obvious would be some future policy of quantitative restriction to preserve supplies of a diminishing resource. The GATT rules brought into the Agreement would prevent anything but a reduction shared by both countries, and the U.S. is given a right to proportionate access to whatever amounts are produced.

Provincial resource management will be threatened by the general operation of the Agreement. The right of the United States to retaliate against programs that violate the often vague terms of the Agreement will mean that the provinces will be under

great pressure to design their policies outside the country, in consultation with the United States. This has happened already as a result of the agreement on softwood lumber trade made by Canada and the U.S. in 1986. Both Quebec and British Columbia have sent delegations to Washington to get U.S. approval of provincial stumpage charges. The Trade Agreement will have this effect in many sectors of the economy, though it too was negotiated without any right of the provinces to object to its terms.

Turning to more specific consequences, the Agreement could provide grounds for a challenge to provincial policies that restrict the export of unprocessed natural resources. For example, section 104 of the Mining Act of Ontario makes all grants or leases of mineral rights in Ontario subject to the condition that ore extracted must be refined in Canada. Failure to meet this condition can lead to the revocation of the grant or lease. This provision effectively prohibits the export of unprocessed ore.

The Agreement itself does not ban this kind of provision. It does, as noted, make the GATT rules part of the Agreement and subject to enforcement by the

dispute resolution procedures of Chapter 18. A resource processing requirement may be alleged to infringe the GATT. As a result, it will be easier for the Americans to challenge our resource processing laws.

Ontario imposes a similar condition on the forestry industry through the Crown Timber Act, section 15. However, since the U.S. has similar laws, the Parties exempted from the Agreement controls on the export of logs (Article 1203(a) and (b)). Fish processing requirements were also exempted for Canadian east coast fisheries (Article 1203(c)). Since these policies are vulnerable under the GATT - Canada's rules about reprocessing in west coast fisheries have already been found by a GATT panel to be a violation - the Agreement does not prohibit either party from challenging resource reprocessing laws under the GATT (Article 1205). In any event, the Agreement nowhere exempts the parties from their obligations to each other under the GATT. Rather, it adds to them. The effect of Chapter 12 is that U.S. challenges to Canada's log export controls and fish reprocessing rules will be harder to make - but not impossible -than challenges to mineral reprocessing laws.

The Agreement will apply also to policies about resources that Canada does not yet export. The main example is water. Canada may not impose quantitative restrictions on the export of water, except as allowed by the GATT. Most of the GATT rules deal with temporary measures to deal with short supply. However, this does not mean that the Agreement will compel an owner to decide to sell water. In Canada, the provinces own the natural resources, including water, though they may sell or licence them.

A federal restriction on the export of water would have to comply with the GATT rules. While conservation is an acceptable reason under the GATT for limiting exports (if domestic consumption is also limited), protection of the environment is not. Limits to water exports may have to come from the owners of the water, the provinces.

While the U.S. does not under the Agreement have any right to insist that the owners of the Canadian resource must start to export water to it, if anyone in Canada does export it in the future, then the Agreement will ensure that Americans have proportionate access to it thereafter.

The pricing of water exports would also be subject to the Agreement. No minimum price may be imposed. Ontario, or any other province, could not introduce a "water-taking fee", say as a conservation measure or as a means of making up social or environmental costs of diverting water, unless the same fee were applied to domestic use. Article 408 prohibits "any tax, duty or charge on the export of a good" that is not also levied on the good "when destined for domestic consumption."

This would not prevent the province as owner of the natural resource from charging what the market would bear for water exports. It does prevent add-on charges and limits the ability to regulate private owners.

The kind of rights and obligations discussed in the energy section will generally apply to other resources.

The ability of Canada or any province to control the potential growth of foreign ownership in resource development industries is restricted by the provisions of Chapter 16 on investment. This Chapter is discussed in more detail later in this study. While

preferential ownership rules for oil, gas and uranium are preserved by paragraph 4 of Annex 1607.3, no special exemption is given for resource industries in general.

The Agreement does not accord the right to national treatment to consumers of goods, services or investments, but only to the providers of goods and services and to investors for business purposes. As a result, provincial policies that favour Canadian residents in access to Canadian resources for recreational use are generally acceptable under the Agreement. Preferential fishing licence or camping permit fees, first access to cottage lots on Crown lands, and similar advantages are not subject to attack.

Where the focus is on commercial users, on the other hand, the Agreement does have an effect. The tourism provisions of the services chapter (Chapter 14) could prevent discrimination against Americans in according licences for guides or fishing camps, or in granting the rights to exploit any other natural resources as a business. Ontario now restricts commercial fishing licences to Canadian citizens. A

new measure of similar scope would be contrary to the Agreement.

In summary, the omission of natural resources by name does not mean that they are not covered in the Agreement, but only that they are not singled out for attention. Provincial policies on the exploitation of natural resources will be seriously affected by the Agreement.

3. Alcoholic Beverages

The provinces and the federal government have long cooperated in the regulation of alcoholic beverages. Federal legislation, the Importation of Intoxicating Liquors Act, prohibits imports of alcohol except through provincial monopolies. This is complemented by activity of the provinces in their own jurisdiction over local distribution and sale. In Ontario, this interlocking scheme has facilitated the development of a maturing wine industry. The survival of the industry is threatened by the arrangement

negotiated by the federal government without the participation of Ontario. This illustrates the dangerous effects of unilateral federal action in trade matters. More such consequences will no doubt appear as the Agreement takes effect.

The Agreement affects three aspects of the commercial sale of wine and distilled spirits: listings, pricing and distribution (Chapter 8). Contrary to the Preliminary Transcript, the Agreement now also applies to beer (Article 1204), though existing practices in selling beer are grandfathered (as of October 4, 1987, rather than the usual grandfathering provision that applies as of January 1, 1989). In other words, the sale of beer has the same status under the Agreement as the sale of services or the rights of investors.

The Agreement expressly leaves the United States free to pursue its domestic trade remedies or GATT procedures against Canadian practices in marketing wine and spirits (Article 807) and beer (Article 1205), so the grandfathering gives limited protection.

The application of the Agreement to beer will restrict the ability of the provinces to modify

their existing policies for its distribution. It may also hinder the gradual dismantling of interprovincial barriers to the sale of beer, since any new system would have to comply with the Agreement, which prohibits almost all discrimination against U.S. brewers. In other words, the Agreement would probably operate to reduce international barriers faster than the provinces wished to reduce interprovincial ones, thus jeopardizing any relaxation of any barriers.

The Agreement provides that listings of wine and spirits in provincial liquor stores must not discriminate against U.S. products, which must receive national treatment. The distribution system must also provide national treatment for American goods, although existing private wine store outlets are grandfathered (once again, as of October 4, 1987). The GATT standards of Chapter 5 of the Agreement apply to both listing and distribution, and expressly include "existing interpretations" of the GATT. Article 201 defines "existing" to mean existing as at January 1, 1989. As a result, the United States will be able to use the Agreement to enforce the recent GATT panel ruling on listing and distribution practices.

The Agreement reduces the powers of some provinces more than those of others. For example, Quebec's policy of allowing the sale of imported wines in grocery stores only if the wine is bottled in Quebec is permitted in the Agreement, but no other province may adopt a similar policy. Likewise, British Columbia gives automatic listing to wines from B.C. estate wineries. This practice is accepted under the Agreement, but not permitted to any other province.

Price differences between domestic and American products may reflect only differences in the cost of stocking them. Article 803 does not require national treatment in pricing (it does not require that Chapter 5 should apply) but goes further to spell out how prices are to be set. Provincial liquor boards will not be able to use normal commercial considerations to charge a premium price for products that can command such prices, if those products are imported from the U.S.

At present, Ontario's practices respecting the sale of alcoholic beverages do not appear to meet these standards in all respects. As a result of the demand management and premium pricing of imported wines, a domestic grape and wine industry has been able

to grow up. This industry is expected to be able to compete on its own with imports by the end of the century. However, the provisions of the Agreement make no allowance for this timetable. The nurturing of this aspect of the provincial economy will be badly damaged by the concessions made to the United States in the Agreement.

4. Services and Temporary Entry

(i) obligations for services

The underlying obligation of the Agreement is to accord "national treatment" to those who provide services named in the Agreement. Despite the general obligation, different treatment is permitted if the difference is no greater than necessary for "prudential, fiduciary, health and safety consumer protection" reasons. In addition, the different treatment must be "equivalent in effect" to the treatment of local residents. The Agreement does not state whether the "effect" is that on the provider of

the service or that on the consumer. Only the latter effect would allow the province to ensure that its measures in these areas could properly take account of the different risks associated with the provision of services by non-residents.

The province will have to demonstrate that such differences in its rules are no greater than necessary and that they are equivalent in effect to the rules for domestic providers of the services. Proving this, even on a reasonable balance of probability, may be very difficult in practice.

All these obligations apply only to future measures. Existing rules are not required to change. Despite the provisions of Article 1402.5 on renewal or continuation of existing measures, it will sometimes be difficult to know when new measures are mere extensions or renewals of existing ones, and thus not covered by the new regime, and when they are sufficiently changed that they must comply with the principles of the Agreement. For example, Ontario is reviewing all its consumer protection and business regulation statutes with a view to combining them into one consistent law. The Agreement may not allow the continuation of present practices not in accord with

the Agreement if they are to be continued in a new statute rather than in amendments to existing statutes.

The province that asserts that it is just continuing or renewing an existing measure is required to prove it in the event of a dispute. This may be very difficult when the measure is an administrative practice rather than a public regulation or statute.

The Agreement guarantees to all U.S. service providers the same right as residents of the province to establish their businesses here and to buy existing Canadian service businesses (Articles 1602.1 and 1601.3). It guarantees to U.S. businesses that provide "covered services" (those in Annex 1408 of the Agreement) the right to conduct their business without arbitrary or unjustifiable discrimination (Article 1402.8), and the right to a "commercial presence", which seems to mean the right to carry on business here without setting up an office or investing in Canada in any way (Article 1401).

Even if Ontario residents or Canadians generally are required to maintain an establishment or minimum assets in Ontario to provide services here, the province cannot impose this requirement on Americans if

it would constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on bilateral trade (Article 1402.8). As pointed out earlier in this study in the section on No Discrimination, at page 20, the Agreement gives no guidance as to the meaning of these terms.

By Article 1403.1, the Parties "recognize" that measures governing the licensing and certification of service-providers "should relate principally to competence or the ability to provide" the service. Article 1403.2 requires the Parties to ensure that licensing and certification measures shall not in the future have the purpose or effect of discriminating against nationals of the other Party.

The extent of the obligation under Article 1403 is unclear. Article 1403.1 appears to be only a statement of intent, without legal obligation. The terms of Article 1403.2 are vague. If, however, Article 1403.1 is imperative, it could impair the ability of the provinces to impose licensing provisions requiring honesty or integrity, or residency. It would also stand in the way of the provinces trying to ensure that providers of services operate in regions where the services are most needed (as, for example, British

Columbia and Quebec now require for foreign-trained doctors). These measures may also be prohibited as denying national treatment to Americans, if only foreigners are governed by such obligations.

The Agreement does not make clear whether the rules in Article 1403 are subject to the valid reasons for refusing national treatment set out in Article 1402.3. In any event, measures that comply with both must also follow Article 1402.8, already mentioned, which imposes a general prohibition of arbitrary or unjustifiable discrimination.

Future attempts to license service providers, such as nutritionists and laboratory technologists, the management of new or used car dealers, insurance brokers, and people who provide commercial post-secondary non-university education, will be subject to the Agreement. These efforts may be impeded by the requirements that licensing criteria not have a discriminatory effect and that the parties encourage mutual recognition of licensing requirements (Article 1403.3).

(ii) coverage

The Agreement covers services in agriculture, forestry, mining, construction, distribution trades, insurance and real estate, various commercial areas including the management of health care facilities, computer and telecommunications and tourism. The regulation of almost all these services falls at least in part within provincial jurisdiction.

The Agreement must be read carefully to determine coverage. The real legal effect is found in the Schedule to Annex 1408, which refers to Standard Industrial Classification numbers (SIC) published by Statistics Canada. The classes described in the SIC code are often broader than the services listed in Annex 1408 "for purpose of reference". For example, the "reference" list says that "health care facilities management services" are covered. The SIC numbers show that these extend to public and psychiatric hospitals, ambulance services, health clinics, nursing homes and professional medical offices, plus the commercial operation, not just management, of blood banks and health laboratories, among others.

Although the federal government's summary of the services chapter claims that "government-provided services" are not covered by the Agreement, the SIC list does not permit such a broad statement. The provision of a service by government is not relevant to its classification for SIC purposes.

Transportation services and financial services except insurance are exempt from the services chapter. Financial services have their own rules, set out in Chapter 17.

Covered services have the right to national treatment as provided in the Agreement. Chapter 16 gives investors in all services, covered or not, the right to national treatment in the establishment, acquisition and sale of a business. Americans can therefore own, if not themselves practise, businesses offering all services. The scope of the right of establishment is not clear. It might not extend to the right to a licence. Non-covered services do not have the right to national treatment in their "conduct and operations". Drawing the line between establishment and conduct will be important to provincial regulation of many vital non-covered services in the health, social service and professional fields.

(iii) temporary entry

The Parties are obliged to provide for the temporary entry of business persons on a list included in the Agreement. Temporary entry means entry without intention to become a permanent resident, since immigration matters as such are not covered by the Agreement.

Annex 1502.1 sets out the only requirements that may be imposed on American business visitors, traders and investors, professionals and intra-company transferees seeking entry into Canada (besides those in the Immigration Act for people seeking permanent residence here). There are few such requirements, and they deal mainly with defining those who fall within the permitted classes. Generally, the Agreement prohibits prior approval procedures, labour certification tests (certifying that Canadians are not available to do the work to be done by the person seeking entry) and the like.

Border controls themselves are a matter of federal responsibility. However, the federal government has cooperated with provinces in the past

regarding provincial rules as well. If the federal government relaxes its border controls as a result of the Agreement, then identifying those providing temporary services here will be harder, and provincial measures designed to regulate the conduct of the businesses will be much more difficult to enforce. The risk of fly-by-night operations will increase.

The list of those guaranteed temporary entry by Chapter 15 appears to cover more people than those simply providing the services listed in Chapter 14. The Agreement does not explain the discrepancy.

5. Investment

Chapter 16 of the Agreement sets out in detail the implications of Article 105 requiring each party to accord national treatment to investors of the other party.

Article 1602 requires that Canada and the provinces accord national treatment to investors of the

other party in the establishment, acquisition, conduct and operation and sale of a business enterprise located in Canada or in the province. A business enterprise is a business that has a place of business, at least one individual employed or self-employed in connection with the business, and assets used in carrying on the business (Article 1611).

The meaning of those rights is not clear. In particular, the scope of the right of establishment remains to be defined. When does "establishment" stop and "conduct and operation" of a business begin? Does establishment cover the purchase of premises, the right to a licence, or the right to hire employees? The distinction is particularly important for services, since non-covered services have the right to national treatment in their establishment but not in their conduct and operation. The ability of provinces to protect local interests in non-covered services (such as education, day care and some forms of health care) depends on the answer.

Because of the definition of business enterprise, it is arguable that the Agreement does not require national treatment of a person who wishes to make a passive investment in land in the other country.

Provinces that control landholding by foreign residents will probably be able to continue to do so, except where an American person wishes to buy land in order to start or carry on an active business. Property management itself can be a business for this purpose, but simple ownership may not.

The Agreement does impair the ability of a province to restrict land ownership by Americans, for example of agricultural lands, since agriculture is a business. Manitoba and Saskatchewan now have such laws, which will be acceptable as "existing measures" under the Agreement. Similar measures by other provinces in the future will be open to attack.

Restrictions on ownership of residential or recreational land will be less affected by the Agreement, except where a business enterprise is established to manage residential or recreational property. Prince Edward Island has such restrictions, and Manitoba has contemplated introducing them. An individual holding for own personal use, even with a view to capital appreciation, is unlikely to constitute such a business for the purposes of Chapter 16.

The Land Transfer Tax Act of Ontario imposes a higher tax on the transfer of land to non-residents than on transfers to residents of Canada. Whether such a measure offends the Agreement will depend on why an American buyer wanted the land. If an American was buying land in Ontario to establish or carry on a business, then such a discriminatory tax would be improper unless Ontario could show that the discrimination was not arbitrary or unjustifiable. The present tax measure is preserved by Article 1607 and 1609.1, but extensions to commercial lands, or a change in the differential rate, could be caught.

A provision of a statute that made non-resident purchasers of Ontario land register with the government would be acceptable under Article 1604. This permits the parties to monitor foreign investment within their territories.

The essential obligation of the Agreement is that Canada and its provinces will have to treat U.S.-owned businesses the same as Canadian-owned businesses. Article 1602.8 provides an exception where different treatment is "no greater than necessary for prudential, fiduciary, health and safety or consumer protection reasons", and has "equivalent effect" to the

treatment accorded Canadians. Few such differences are likely to arise for businesses trading in goods. The provision of services in the province may be more in need of specific rules for Americans. These might deal with the recognition of competence, the ability to meet financial responsibilities, and the like, areas where the rules applied to residents of Ontario are not easily applicable to the circumstances of foreigners.

Existing measures are grandfathered by Article 1607, with the same difficulties of proof and of determining the allowable scope of subsequent amendments that have been discussed elsewhere.

Discrimination among businesses to ensure local control of the economy will not be allowed under the Agreement, except through express exemptions for some of the rules now applied by Investment Canada. "Trade related investment measures" (TRIMS) are generally disallowed. Article 1603 prohibits Canada from imposing requirements on an American as a condition of permitting an investment. It also precludes regulating the conduct of a business in Canada through such means as requiring the export of a given level of goods, or the substitution local for imported goods, or the local sourcing of supplies, or

the achievement of a certain level of domestic content in the goods or services created in Canada.

Ontario does not now impose any such conditions, as a rule, except in the allocation of subsidies. Businesses wanting assistance to locate in eastern or northern Ontario are required to source supplies locally and to bring, as it were, a calculated economic benefit to the region in return for the subsidy.

Other forms of subsidy programs do not accord national treatment. The Small Business Development Corporations Act of Ontario gives tax credits to businesses that will inject venture capital into small businesses, but only Canadian-controlled private corporations (as defined in the Income Tax Act) are eligible. Some other regional development subsidies also restrict their availability to Ontario or Canadian residents.

Article 1609 provides that the Agreement does not affect new tax measures or subsidies, unless they constitute a means of arbitrary or unjustifiable discrimination against Americans or "disguised restrictions on the benefits" under the investment

chapter. Existing measures, such as those described above, are not affected by these rules. Future subsidies and tax measures, and amendments to existing programs, designed to stimulate the local economy will have to meet these standards, whose meaning is not at all clear. It remains to be seen whether any measures that differentiate between Canadians and Americans will be considered non-arbitrary and justifiable only, if at all, by the criteria of Article 1602.8.

Most of the control of foreign investment in Canada has been the work of the federal government. However, the provinces have often been consulted as part of the review process. Raising the threshhold for review and abolishing all reviews for new businesses reduces the scope of provincial influence on economic activity in the province. The Agreement restricts the ability of any level of government to take new measures to control investment. In addition, the investment chapter of the Agreement has important effects on the rights accorded in the field of providing services, as suggested above.

Article 1605 prohibits expropriation or "any measure or series of measures tantamount to an expropriation" except on a non-discriminatory basis and

on payment of full compensation. As noted in the monopolies chapter of this paper, this might have rendered the creation of generally accepted public sector enterprises such as public health care prohibitively expensive. The result may be to prevent further initiatives of a similar kind.

Articles 1602.5 - 1602.7 allow Canadian governments to provide that public enterprises or Crown corporations sold to the public shall remain in Canadian hands, in that national treatment of Americans is not required on the acquisition or sale. However, for such enterprises or Crown corporations created after January 1, 1989, only the first sale to the public can be restricted to Canadians. Subsequent sales by the first purchasers must be open to Americans. This rule could inhibit the creation or the privatization of Crown corporations, since the flexibility of means of maintaining Canadian ownership is limited.

6. Financial Services

The Agreement provides a set of rules for regulating financial services that straddle federal and provincial regulatory jurisdictions. However, the Agreement exempts from its coverage provincial regulations relating to financial institutions (Article 1701.2), except for insurance companies (Article 1601.2(a)). Insurance services are subject to Chapter 16 on investment rights and, as covered services (Article 1408), to Chapter 14 on services as well.

The Agreement adopts the legal definition of "financial institution" used by each Party in its own laws (Article 1706). As a result, it is open to debate just what institutions in Canada are covered by the Agreement. Federal and provincial jurisdiction over financial institutions is divided, except in the case of banks, and the legal definition of "bank" is not entirely clear for constitutional purposes.

The Agreement may prevent a province from ensuring that the control of financial resources collected from residents of the province by insurance companies and invested for the development of the province can be kept in Canadian hands. Present rules for investment by insurance companies allow some kinds of foreign investment, but provincial economic policy might wish to control this in the future.

Article 1402.8 prohibits any Party, including a province, from introducing any measure that constitutes an arbitrary or unjustifiable discrimination between persons of the Parties or a disguised restriction on trade in covered services. This provision may be intended to prevent restrictions such as those imposed by Ontario on part-time insurance agents. While present rules are grandfathered under the Agreement, future amendments may be caught and the power of the province to regulate how insurance services are offered here may be impaired.

The Agreement provides for further talks with the United States on the regulation of financial services, while preserving all existing rights of U.S.-controlled financial institutions in Canada in the

meantime. It is essential to Ontario that any new rules must not impair unnecessarily its duty to protect the interests of its citizens and of its investors.

7. Culture

The Agreement purports to exempt "cultural industries" from its provisions. Article 2005 contains the relevant language and Article 2012 the definitions. Certain recognized provisions are nonetheless dealt with, namely retransmission rights, "print in Canada" requirements, and compulsory sale of foreign-owned cultural enterprises on a change of control. However, the Agreement also contains a serious warning to those who would take comfort from the apparent exemption. Immediately after the exemption, in Article 2005.2, the Agreement provides,

> Notwithstanding any other provision of this Agreement, a Party may take measures of equivalent commercial effect in response to actions that would have been inconsistent with this agreement but for paragraph 1 [the exemption].

Canada and the provinces often take measures to protect their cultural industries, such as tariffs or citizenship requirements or favourable procurement policies. Ontario has measures to favour Canadian publishing, for example, such as the requirement that foreign-owned paperback and periodical distributors operate in strictly controlled areas while Canadian distributors are not subject to such restrictions. If these measures would, except for the "exemption", be forbidden under the Agreement, then the United States may retaliate against Canada with "measures of equivalent commercial effect".

This is apparently a new right to retaliate, aside altogether from whatever remedies existing American law might provide against Canadian cultural protection. The key provision of existing U.S. law is section 301 of the Trade Act of 1974, which allows the executive to remedy "unfair trading practices" that affect American exports. Other existing American trade laws may be of little relevance if they simply apply remedies, such as duties, to imports into the U.S., since Canadian cultural measures usually affect only the internal Canadian market.

The Americans have, as a result of a successful s. 301 action, passed "mirror" legislation imposing penalties on Canada in response to the Canadian prohibitions on tax deductions for advertising on border broadcasting stations. The Agreement now provides a contractual right to retaliate in all cases. In practice, the rules of the Agreement will probably operate as a new means of measuring the "unfairness" of cultural protection measures that are made the object of a s. 301 action.

The person claiming to be aggrieved by an Ontario cultural measure can therefore proceed directly under U.S. law, and does not have to persuade the American government to take the matter to the binational dispute settlement process.

It is difficult to claim that the cultural industries are exempt from the Agreement simply because Canadian measures to protect culture do not technically violate it. This is because the Americans' right to retaliate against cultural measures does not depend on a violation. It has been suggested that Article 2005.2 simply recognizes the existence of the legal rights the U.S. already has, rather than adding anything new. Whether the Agreement gives a new right or recognizes

an old one, the Americans' right to retaliate would have been no greater if the whole "exemption" for culture had been omitted.

It should also be noted that the measures of equivalent commercial effect do not have to be levied against cultural targets, but rather may be applied wherever the United States thinks they will have the most impact. These measures might therefore be used to put pressure on Canada in some other area of trade relations, or simply to create a group of Canadians who will be harmed by the retaliation against cultural measures and who may thus press for a reduction of cultural protection.

This is not a theoretical concern. The right to fight against cultural measures by retaliation against any sector of the Canadian economy was expressly mentioned by the U.S. Trade Representative in recent documents submitted to the Finance Committee of the U.S. Senate.

VI. Enforcing the Agreement

Partly because of the overlap in federal and provincial powers, and partly because of a desire to get along in the real world despite the rigidities of constitutional law, rules and practices have grown up to allow governments to govern without constant regard for their legal domains. However, cooperation between governments can be threatened if either party, particularly the federal government, chooses to use the rules or change the practices in order to insist on achieving a particular result, without regard to the long term effect on the relationship.

The Agreement requires that the Parties use all necessary measures to ensure that all orders of government comply with its terms. If at any time during the duration of the Agreement any government in Canada does not comply, then the federal government must under the Agreement take whatever measures are necessary. It might attempt traditional means of persuasion before passing on to the more radical methods.

It is crucial to note, however, that the Agreement sets no limits on what the federal government is obliged to do in case of continued lack of compliance. Paramount legislation to override that of the province, the declaratory power, the disallowance power, the withdrawal of federal interlocking legislation in areas of joint regulation with the provinces, and the full scope of federal spending power can all be called on. These methods must be considered as part of the federal arsenal, with the Americans in a position to require the use of some or all of them. Failure to use any of them in the case of persistent non-compliance would itself constitute a breach of the Agreement on the part of Canada.

As a result, the United States assumes the position of a third party at the constitutional negotiating table with the federal government and the provinces. By insisting that Ottawa use all its rights to enforce the Agreement, it will be able to prevent compromises that might otherwise develop.

1. The Extent of the Agreement

The Agreement provides as follows, at Article 103:

> The Parties to this Agreement shall ensure that all necessary measures are taken in order to give effect to its provisions, including their observance, except as specifically provided elsewhere, by state, provincial and local governments. [emphasis added]

As a matter of law, only Canada and the United States are parties to the Agreement, and only they are bound by it. The "subnational units" - the states and the provinces - are not parties and are not bound. The power of the Canadian federal government to make treaties does not give it any more power to implement them internally than is given by the Constitution for domestic legislation. This is the rule in the Labour Conventions case, decided by the Judicial Committee of the Privy Council in 1937. The American government does have such a power, though it may be used with caution where political opposition in the states would be strong.

Since the parties to the Agreement are the federal governments, the obligations are theirs alone. The provinces are not bound by the Agreement directly. A complaint that a province is doing something that is not in accord with the Agreement must therefore be brought in the form of a complaint that the federal government has not lived up to its obligations under the Agreement. The federal government must to exercise its own powers in a manner that will promote provincial conformity with the Agreement. The responsibility for doing this, or for failing to do it, rests on the federal government in international law.

As a result of this constitutional rule in Canada, the federal government has worked hard over the years to include in its international treaties some recognition of its inability to promise compliance by the provinces. For example, Canada's obligations under the GATT are, in cases of provincial jurisdiction, to take "such reasonable measures as may be available" to have the provinces comply (Article XXIV:12 of the GATT). The federal government has argued before the GATT that "available" measures may not be "reasonable" in the constitutional - and ultimately political -climate in Canada. As a result, it was not obliged by the treaty to exercise all the legal powers technically

available to it under the Constitution.

In more recent treaties, in matters of human rights and private international law involving provincial jurisdiction, Canada has often succeeded in including a "federal state clause" that allows for the treaty to come into force across Canada province by province as the provinces choose to implement it. Such clauses are now common in conventions of the Hague Conference on Private International Law and the United Nations Commission on International Trade Law (UNCITRAL). The Hague Child Abduction Convention has recently come into force in all provinces and territories of Canada on a gradual basis. The UNCITRAL Convention on the International Sale of Goods seems likely to come into force in some provinces before it does in others, by virtue of its federal state clause. In many areas, the international community has come to accept these provisions as one of the peculiarities of dealing with Canada.

The "all necessary measures" clause of the Free Trade Agreement thus represents a substantial departure from prevailing Canadian practice in treaty drafting. Professor Ivan Bernier of Laval University has called it "the very opposite of a traditional

federal clause", as it denies rather than recognizes the limits on federal power to bind the whole country to an international obligation.

Article 103 also represents a significant admission that not all the obligations in the Agreement depend on the usual sources of federal competence under the Constitution. The wording contemplates a deliberate extension to matters under provincial control and the use of unusual measures to permit the federal government to ensure compliance with this aspect of the Agreement without provincial consent if necessary. By this clause, the federal government agrees to compel the provinces to implement the Agreement, to the extent that it can do so.

This clause threatens the kind of federal-provincial accommodation that has characterized much of the recent development of Canadian constitutional affairs. It contains no limits, whether of politics or of reasonableness. The range of measures available to the federal government has been outlined above. Failure to use all of them to compel a reluctant province to fall into line could constitute a breach of the Agreement. As noted above, the federal government would not be expected to use all of them at the outset,

or at the same time. It has, however, a clear obligation to use them rather than to tolerate a continuing failure of compliance on the part of a province or municipality.

This breach (failing to use all necessary measures) could be brought before a dispute resolution panel, and ultimately could lead to American retaliation against Canada for provincial actions taken entirely within provincial jurisdiction.

2. American Retaliation

Provincial actions may be the subject of complaints and of proceedings before the panels established under the Agreement. By the terms of the Agreement, the federal government is responsible for provincial measures that do not comply with its terms, as each Party has to ensure that effect is given to the provisions of the Agreement by the provinces or states (Article 103). The Preliminary Transcript expressly mentioned referring provincial actions to dispute settlement, but the language of the final text is just as clear in its effect. However, it is important to

note in this discussion that "Party", in the context of initiating a reference to dispute settlement, refers only to the federal governments. Only they have the right to complain to the Commission, or to make submissions to panels, or to decide to comply or to retaliate.

If a province regulates its economy or otherwise acts in a way that the United States thinks violates the Agreement, the United States can submit a dispute for resolution on the ground that Canada has not taken all necessary measures to ensure provincial compliance. It can back up this allegation with retaliation if its complaint is upheld by a panel and the offending measure is not remedied.

What does this mean to federal-provincial relations within Canada? The Agreement threatens our traditional system in part by inserting a third party, the United States, with the right to insist on legal solutions to problems of economic regulation, problems that Canadians have tended to settle among themselves without recourse to legal remedies. The flexibility of both federal and provincial governments to accommodate the needs of the other will be reduced if the United

States can call for application of the Agreement and retaliate economically if this is not forthcoming.

This result is accomplished with no necessary change to the distribution of Canadian constitutional powers. The provinces need not even be "bound" by the Agreement to feel concern about the damage done by U.S. retaliation. Under the agreement between Canada and the United States on softwood lumber, Quebec and British Columbia have sent representatives to Washington to get approval for their plans to regulate their natural resources through stumpage fees. The present Agreement may effectively require that many provincial policies be approved by the United States before they are put into effect.

It need hardly be pointed out that the power of Canada to retaliate effectively against the United States is negligible compared to the American power against Canada. Its sanctions hurt a large part of Canada's exports of almost any product; Canada's sanctions touch only a small portion of American trade. This problem was demonstrated by Canadian retaliation against the U.S. safeguard duties on imports of cedar shakes and shingles from Canada. The Canadian "reprisal" duties on imports of Christmas trees,

teabags and books from the United States were felt by Canadian importers and consumers, but very little, if at all, by the United States.

As a result, the United States can influence Canadian federalism through the dispute resolution procedures, but Canada's chances of putting pressure on the U.S. are much less strong. Ironically, Canada will not be able in practice to enforce the American obligation to impose the Agreement on the states, though the U.S. government has clear legal authority to do so. The United States may in practice be able to enforce the Canadian government's obligation despite the much less clear constitutional position in Canada.

CONCLUSION

The Free Trade Agreement between Canada and the United States has an extensive impact on the power of the provinces to control their economy. This impact is not merely incidental or temporary but involves a systematic reduction of the freedom of Canadians to

make policy. As a consequence, the Agreement effects a change of constitutional dimensions in federal-provincial relations in Canada, even though it does not touch the wording of the Constitution.

Besides the catalogue of particular points of impairment that has been set out in this study, special concern may be focussed on the future of cooperative relations between the two levels of government in Canada. The Agreement has brought another party to the federal-provincial bargaining table: the United States. The ability of the United States to insist on legal rights where Ottawa and the provinces have often compromised and cooperated fundamentally alters the Canadian tradition. This is one of the most important effects of the Agreement on the Canadian constitution.

The federal government cannot give itself increased power over matters allocated in the Constitution to provincial governments merely by signing an international agreement on these subjects. Whether it can find in its own jurisdiction a sufficiently broad competence to impose the limits of the Agreement on the provinces in all domains remains

to be judged according to the means chosen to achieve that end.

Challenges to any aspect of the Agreement need not come from a provincial government, but may evolve out of private disputes. Both private parties and provincial governments will be closely analysing the means chosen by the federal government, not just in the first instance but over the course of the next years, to ensure that the Agreement is brought into force in Canada. Some of the reasons for careful scrutiny of these means have been set out in this discussion.

The answers that Canadians give to the questions of whether and how to implement the Agreement are crucial to the way Canada's economy is to be governed in the foreseeable future.

The Impact of the Canada/U.S. Trade Agreement: A Legal Analysis

EXECUTIVE SUMMARY

Attorney General for Ontario

May 1988

The Impact of the Canada - U.S. Trade Agreement

A Legal Analysis

SUMMARY

The Trade Agreement signed by Canada and the United States is one of the most significant public policy initiatives in the history of our country. The Government of Ontario commissioned this Study in order to assess whether or not this Agreement, in addition to its obvious economic significance, will bring with it changes of a legal nature.

The analysis has included an examination of the Agreement, the available information on its impact on a sector-by-sector basis, the General Agreement on Tariffs and Trade (incorporated by reference at many important points of the Agreement) and the underlying principles of our constitutional law.

The principal findings of this study are

- under the Agreement, the United States becomes a third party at the constitutional bargaining table, empowered to influence a wide range of vital public policies;
- the new role of the United States in the making of Canadian public policy threatends the traditional patterns of compromise that have characterized Canadian federalism;
- the Agreement will significantly alter the ability of the provinces to shape their economic and social policies;
- the impairment of the policy flexibility of the provinces is so profound that it gives the Agreement a constitutional dimension;
- provincial measures can be subjected to review and ultimately to U.S. retaliation without any certain right under the Agreement for the provinces or private sector interests to be heard or to participate in any way;
- the Agreement impairs provincial policy making through:

    i. the undertaking of the federal government to "ensure that all necessary measures are taken" to ensure the observance of the

Agreement, including by the provinces and municipalities;

ii. the "national treatment" rule, which in general requires that American business interests be accorded treatment equivalent to that granted to Canadians;

iii. the "no discrimination" rule, which sets up a test of uncertain meaning for the validity of new provincial regulatory measures, taxes, subsidies and technical standards; and

iv. the "nullification and impairment" rule which permits attack on and retaliation against any provincial measure that "nullifies" or "impairs" the benefits "reasonably expected" under the Agreement, **even if it does not violate the Agreement;**

- the most severe effects on provincial activity will ultimately be felt in the areas of:

  i. energy , where the scope of two price energy policy as a provincial tool for economic development will be restricted;

  ii. natural resources, which are subject to compulsory sharing with the United States in times of shortage and for which licencing for commercial use and access must be accorded equally to Americans and Canadians; this applies to sales of water to the United States;

  iii. alcoholic beverages, where wine listing and pricing policies will have to provide national treatment to U.S. wines without the favourable treatment given to non-conforming practices of Quebec and British Columbia;

  iv. services, where American service providers have been given the right to establish businesses in Canada and to acquire Canadian service businesses with limitations on the power of the provinces to

differentiate between Canadians, or provincial residents, and Americans;

v. investment, in which trade related investment measures are forbidden and subsidies and taxes may not in general deny national treatment to Americans in the future;

vi. subsidies, in which Canada continues to be exposed to U.S. retaliation against regional development and labour adjustment measures, under the Agreement and under existing U.S. laws, and in respect of which Canada has committed itself to a five to seven year negotiation which may result in constraints on one of the province's most important instruments of economic development policy; and

vii. cultural industries, support for which is the subject of a specific right of retaliation under the Agreement;

- implementation of the Agreement in areas of current provincial activity raises serious questions of legislative competence and in particular

  i. is not justified under the federal government's treaty making powers as presently defined; and

  ii. would necessarily involve the full exercise of federal powers, even in areas traditionally characterized by accommodation and restraint.